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This is the second of two cables transmitting the 2005 Investment Climate Statement for Turkey:

¶9. EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

The government has taken a number of important steps in recent years to strengthen and better regulate the banking system, whose weaknesses had contributed to macroeconomic instability over the previous decade and played an important role in the 2000-2001 financial crisis.

A 1999 banking law established an independent Banking and Regulation and Supervision Agency (BRSA) to monitor and supervise Turkey's banks. The BRSA, which began functioning in 2000, is headed by a board whose seven members are appointed by the cabinet for six-year terms. The law's provision's also toughened conditions for establishing new banks or branches, set credit limits to protect bank solvency, and strengthen regulatory and sanctioning powers, including authorizing the board to merge weak banks with stronger ones.

The law also created an independent deposit insurance agency, the State Deposit Insurance Fund (SDIF). Until 2004, BRSA and SDIF had the same board and shared staff and offices, though they were separate legal entities. Since the beginning of 2004, BRSA and SDIF's boards and staffing have been separated and SDIF's headquarters moved to Istanbul.

During and after the 2000-2001 financial crisis, many Turkish banks became insolvent or undercapitalized, and SDIF, in coordination with BRSA, took over 21 financial institutions. This includes Imar Bank, which was taken over on July 4, 2003. The SDIF has recapitalized these banks, and has been selling or liquidating them, at the same time as it is negotiating repayment agreements from the banks' former owners covering these banks' portfolio of credits to affiliated companies. The BRSA also has issued a regulation limiting the extent of connected lending (between a bank and related corporate entities) and requiring frequent BRSA on-site monitoring.

In early 2005, the government is preparing a new banking law that helps to bring the bank regulatory framework in line with European Union norms. Once enacted, the new law is expected to further tighten bank regulation, notably by broadening the range of expertise inspectors can draw on when conducting on-site inspections.

Following the 2001 crisis, the government restructured state-owned banks, minimizing the scope for political interference, liquidating one of the banks, and slating these banks for eventual privatization. However, the process of privatizing the three remaining state-owned banks has stalled.

Because of high local borrowing costs and short repayment periods, both foreign and local firms frequently seek credit from international markets to finance their activities. As of end-2004, there were 48 commercial banks (including 12 foreign banks) and 14 development or investment banks operating in Turkey. Total sectoral assets were approximately USD 184 billion, or about 70 percent of GNP, as of July 2004 according to data from the Banking Regulation and Supervision Board. The three state-owned commercial banks and the top 4 privately-capitalized banks hold approximately 74 percent of total assets.

There is a regulatory system established to encourage and facilitate portfolio investments, though it needs improvements in transparency, accounting, and enforcement provisions to bring it up to EU and U.S. standards. The Istanbul Stock Exchange (ISE), formed in 1986, is becoming a significant emerging market stock exchange. As of January 2005, 276 companies were listed on the exchange. However, Turkey has yet to develop other capital markets. The Capital Markets Board is responsible for overseeing the

activities of capital markets, including activities of ISE-quoted companies, and securities and investment houses. A new Capital Markets Law is under consideration.

The Turkish private sector is dominated by a number of large holding companies, whose upper management is family-controlled. Most large businesses continue to float publicly only a minority portion of company shares in order to limit outside interference in company management. There has been no attempt at a hostile takeover by either international or domestic parties in recent memory.

There are no laws or regulations that specifically authorize private firms to adopt articles of incorporation or association in order to limit or prohibit foreign investment, participation, or control. Neither is there any attempt by the private sector or government to restrict foreign participation in industry standard-setting consortia or organizations.

¶10. POLITICAL VIOLENCE

Terrorist bombings -- some with significant numbers of casualties -- over the past two years have struck religious, political, and business targets in a variety of locations in Turkey. The potential remains throughout Turkey for violence and terrorist actions against U.S. citizens and interests, both by transnational and indigenous terrorist organizations.
In November 2003 the Al-Qa'ida network was responsible for four large suicide bombings in Istanbul that, among other targets, hit western interests. Indigenous terrorist groups also continue to target Turkish as well as U.S. and Western interests. In June 2004 the indigenous terrorist group PKK/KADEK/KONGRA GEL announced an end to their "unilateral ceasefire." Since the announcement, there have been repeated attacks against Turkish targets in the southeast region of Turkey, where the group has traditionally concentrated its activities. In addition, there have been bombings and other incidents in Istanbul, Bodrum, Antalya, and Mersin. Other terrorist groups, including the Turkish group Revolutionary People's Liberation Party/Front (DHKP/C), continue to target Turkish officials and various civilian facilities and may use terrorist activity to make political statements. In 2002, 2003, and 2004, civilian venues such as courthouses and fast food restaurants were the targets of minor bomb attacks, which have resulted in small numbers of casualties among bystanders. Similar, random bombings are likely to continue in unpredictable locations. Americans traveling to Southeastern Turkey, the site of PKK/KADEK/KONGRA GEL actions, should exercise caution.

Although the Turkish government takes air safety seriously and maintains strict controls, particularly on international flights, hijacking attempts have occurred as recently as ¶2003. For the latest security information on Turkey and throughout the world, travelers should monitor the State Department web site http://travel.state.gov, where the current Worldwide Caution Public Announcement, Travel Warnings, and Public Announcements can be found.

¶11. CORRUPTION

CORRUPTION IS PERCEIVED TO BE A MAJOR PROBLEM IN TURKEY BY PRIVATE ENTERPRISE AND THE PUBLIC AT LARGE, PARTICULARLY IN GOVERNMENT PROCUREMENT. AMERICAN COMPANIES OPERATING IN TURKEY HAVE COMPLAINED ABOUT BEING SOLICITED, WITH VARYING DEGREES OF PRESSURE, BY MUNICIPAL OR LOCAL AUTHORITIES FOR "CONTRIBUTIONS TO THE COMMUNITY". PARLIAMENT CONTINUES TO PROBE CORRUPTION ALLEGATIONS INVOLVING SENIOR OFFICIALS IN PREVIOUS GOVERNMENTS, PARTICULARLY IN CONNECTION WITH ENERGY PROJECTS. IN 2003, AFTER THE GOVERNMENT INTERVENED IN A BANK OWNED BY THE UZAN GROUP, EVIDENCE OF CORRUPT PRACTICES AT THE BANK EMERGED.
Recent public procurement reforms were designed to make procurement more transparent and less susceptible to political interference, including through the establishment of an independent public procurement board with the power to void contracts. The judicial system is also perceived to be susceptible to external influence and to be biased against outsiders to some degree.

Turkish legislation outlaws bribery and some prosecutions of government officials for corruption have taken place, but enforcement is uneven. Turkey ratified the OECD Convention on Combating Bribery of Public Officials, and passed implementing legislation in January 2003 to provide that bribes of foreign officials, as well as domestic, are illegal and not tax deductible. In 2003, Turkey signed the UN Convention Against Corruption.
The Prime Ministry's Inspection Board, which advises a new Corruption Investigations Committee, is responsible for investigating major corruption cases. Nearly every state agency has its own inspector corps responsible for

investigating internal corruption. The National Assembly can establish investigative commissions to examine corruption allegations concerning Cabinet Ministers for the Prime Minister; a majority vote in the parliament is needed to send these cases to the Supreme Court for further action.

Transparency International has an affiliated NGO in Istanbul.

¶12. BILATERAL INVESTMENT AGREEMENTS

Since 1985, Turkey has been negotiating and signing agreements for the reciprocal promotion and protection of investments. Turkey has signed or initiated negotiations on bilateral investment treaties with 69 countries. Fifty-two of these agreements are now in force, including with the United States, United Kingdom, Germany, the Netherlands, Belgium, Luxembourg, Denmark, Austria, Sweden, Switzerland, Spain, Finland, Italy, Portugal, Hungary, Poland, Romania, Tunisia, Kuwait, Bangladesh, China, Japan, South Korea, Indonesia, Croatia, Cuba, the Czech Republic, Estonia, Russian Federation, Azerbaijan, Kazakhstan, Georgia, Tajikistan, Ukraine, Uzbekistan, Belarus, Lithuania, Latvia, Slovakia, Macedonia, Pakistan, Turkmenistan, Moldova, Kyrgyzstan, Albania, Bulgaria, Argentina, Bosnia, Malaysia, Egypt, Mongolia, Greece and Israel.

Turkey's bilateral investment treaty with the United States came into effect on May 18, 1990. A bilateral tax treaty between the two countries took effect on January 1, 1998. Turkey has signed avoidance of double taxation agreements with 59 countries; 39 of these are in force.

¶13. OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The Overseas Private Investment Corporation (OPIC) offers a full range of programs in Turkey, including political risk insurance for U.S. investors, under its bilateral agreement with Turkey. OPIC is also active in financing private investment projects implemented by U.S. investors in Turkey. OPIC-supported direct equity funds, including the USD 200 million Soros Private Equity Fund can make direct equity investments in private sector projects in Turkey. Small- and medium-sized U.S. investors in Turkey are also eligible to utilize the new Small Business Center facility at OPIC, offering OPIC finance and insurance support on an expedited basis for loans from USD 100,000 to USD 10 million. In 1987, Turkey became a member of the Multinational Investment Guarantee Agency (MIGA).

The U.S. Government annually purchases approximately USD 24 million of local currency. Embassy purchases are made at prevailing market rates, which fluctuate in accordance with Turkey's free floating exchange rate regime.

¶14. LABOR

The Turkish labor force numbers 25.3 million (22.9 million employed and 2.4 million unemployed); 35.9 percent of the workforce is in agriculture. The official unemployment rate was 9.5 in the third quarter of 2004.

Students are required to complete eight years of schooling and to remain in school until they are 15 years old. Turkey has an abundance of unskilled and semi-skilled labor. However, there is a shortage of qualified workers for highly automated high-tech industries. Individual high-tech firms, both local and foreign-owned, have generally conducted their own training programs for such job categories. Vocational training schools for some commercial and industrial skills exist in Turkey at the high school level. Apprenticeship programs, both formal and informal, remain in place, although they are dying out in some traditional occupations. Turkey's labor force has a reputation for being hardworking, productive and dependable.

Labor-management relations have been generally good in recent years. Employers are obliged by law to negotiate in good faith with unions that have been certified as bargaining agents. Strikes are usually of short duration and almost always peaceful. Since 1980 Turkey has faced criticism by the ILO, particularly for shortcomings in enforcement of ILO Convention 87 (Convention concerning Freedom of Association and Protection of the Right to Organize) and Convention 98 (Convention concerning the Application of the Principles of the Right to Organize and to Bargain Collectively).

IN 2002, PARLIAMENT APPROVED A JOB SECURITY BILL, PROVIDING BASIC JOB SECURITY FOR WORKERS AND REQUIRING A VALID REASON FOR THE TERMINATION OF THE LABOR CONTRACT AT THE INITIATIVE OF THE EMPLOYER. THE LAW CAME INTO EFFECT ON 15 MARCH 2003. IN 2003, THE LABOR LAW OF 1971 (NO.1475) WAS REPLACED BY A NEW LABOR LAW (NO.4857), WHICH PROVIDED EMPLOYERS WITH GREATER FLEXIBILITY IN THE ORGANIZATION OF WORK AND WEAKENED TO A CERTAIN EXTENT THE JOB SECURITY PROVIDED BY THE 2002

LAW.

In 1995 and 2001, constitutional amendments reduced restrictions on freedom of association and political activity of trade unions. However, the restrictions on the right to strike under Article 54 of the Constitution were preserved intact. Under the Law on Collective Labor Agreements, Strikes and Lockouts, some restrictions on the right to strike were repealed in 1988. Civil servants (defined broadly as all employees of central government ministries, including teachers) are allowed to form trade unions and to engage in limited collective negotiations, but are prohibited from striking.

¶15. FOREIGN TRADE ZONES/FREE PORTS

Firms operating in Turkey's free zones have historically enjoyed many advantages, but these will be limited in the future by recent legislation. Twenty-one zones have been established since passage of the Turkish law on free zones in 1985. The zones are open to a wide range of activities, including manufacturing, storage, packaging, trading, banking, and insurance. Foreign products enter and leave the free zones without payment of any customs or duties. Income generated in the zones is exempt from corporate and individual income taxation and from the value-added tax, but firms are required to make social security contributions for their employees. Additionally, standardization regulations in Turkey do not apply to the activities in the free zones, unless the products are imported into Turkey. Sales to the Turkish domestic market are allowed, with goods and revenues transported from the zones into Turkey subject to all relevant import regulations. There are no restrictions on foreign firms operations in the free zones. Indeed, the operator of one of Turkey's most successful free zones located in Izmir is an American firm.

Law 5084 revised the free zones law to effectively eliminate certain income and corporate tax immunities for the zones. Under the new rules, taxpayers who possessed an operating license as of February 6, 2004 will not have to pay income or corporate tax on their earnings in the zone for the duration of their license. Earnings based on sale of goods manufacturing in a zone will be exempt from income and corporate tax until the end of the year in which Turkey becomes a member of the European Union. Earnings secured in a free zone under corporate tax immunity and paid as dividends to real person shareholders in Turkey or to real person or legal-entity shareholders abroad will be subject to 10 percent withholding tax. The tax immunity of the wage and salary income earned by persons employed in the zones by taxpayers possessing an operating license as of February 6, 2004 will remain in effect until December 31, 2008, or the expiration date of the operating license, whichever is earlier. The implications of the new rules are complex, and interested parties may want to consult with a tax advisor and/or the Foreign Trade Undersecretariat (web site: www.dtm.gov.tr).

¶16. FOREIGN DIRECT INVESTMENT STATISTICS
With the foreign investment permit requirement in place until 2003, the Turkish Treasury collected detailed sectoral and country of origin data for authorized FDI. Data collected since the abolition of the permit requirement, by the Central Bank and other entities, may not be directly comparable to data collected prior to 2003.

According to Turkish Treasury data, as of June 2003, there are 6,511 foreign firms invested and are operating in Turkey. The Turkish government has provided permits for foreign capital since 1980 amounting to USD 35.2 billion, and aggregate actual inflows reached USD 16.4 billion. In 2003, EU countries accounted for 74.3 percent of authorized new foreign investment, OECD countries accounted for 93.7 percent, and Islamic countries for 3.7 percent. Over the past two decades, France (16.4 percent) has been the top source of foreign investment, followed by the Netherlands (15.8 percent), Germany (13.0 percent) and the U.S. (11.5 percent) (Note that these figures are based on the amount of authorized investment, not on actual capital inflows.) Because of the absence of a bilateral tax treaty until 1998, much U.S.-origin capital was invested in Turkey through third-country subsidiaries. According to U.S. Commerce Department data, U.S. company investment amounted to about USD 2 billion in 2003. By unofficial estimates, the U.S. may be one of the largest sources of foreign investment in Turkey.

In 2003, about 58.9 percent of authorized foreign investment took place in manufacturing, 30.23 percent in services, 10.3 percent in mining and 0.6 percent in agriculture. The sub-sectors with the greatest amount of authorized foreign investment include banking (10.6 percent); communications (9.4 percent); food, beverage and tobacco processing (8.0 percent); and trade (6.5 percent). Between 1980 and June 2003, 53.0 percent of actual capital inflows were invested

in manufacturing, 44.0 percent in services, 1.8 percent in agriculture, and 1.2 percent in mining. The finance and communications sectors received the highest share of increased foreign direct investment permits in 2003.

FDI Inflow by Years (million USD)

Year	Actual Inflow	Inflow/GDP	No firms (Cumulative)
1980-1988	1,172		
1989	663	0.80	1,525
1990	684	0.67	1,856
1991	907	0.69	2,123
1992	911	0.78	2,330
1993	746	0.56	2,554
1994	636	0.64	2,830
1995	934	0.66	3,163
1996	914	0.53	3,582
1997	852	0.54	4,068
1998	953	0.49	4,533
1999	813	0.41	4,950
2000	1,707	0.85	5,328
2001	3,288	2.21	5,841
2002	1,042	0.48	6,280
2003	1,702	0.71	6,511
2004(*)	2,216	1.02	N/A
TOTAL	20,140		6,511

Source: Central Bank of Turkey, State Institute of Statistics,
(*)January through November 2004.
(**) Includes capital inflows, foreign loans and real estate investment.

FDI Inflow by Source Country (1999-2002/ million USD)

Country	Cumulative Value	Share (percent)
Italy	1,968	30.9
Netherlands	962	15.1
U.S.A.	793	12.4
United Kingdom	647	10.1
Germany	514	8.1
Bahrain	323	5.1
Japan	267	4.2
France	263	4.1
Switzerland	104	1.6
Belgium-Luxemburg	25	0.4
Spain	23	0.4
Others	488	7.7
Total	6,377	100.0

Source: Turkish Treasury Undersecretariat, General Directorate of Foreign Investment. Updated information has not been issued for the period following 2002.

Sectoral Breakdown of FDI Permits (1980-2003*/ million USD)

Sector	Cumulative Value	Share (percent)
Manufacturing	18,641	53.0
Services	15,453	44.0
Agriculture	616	1.8
Mining	442	1.2
Total	35,152	100.0

Source: General Directorate of Foreign Capital
(*) as of June 2003

Main Manufacturing Industry Sub-Sectors Receiving FDI Permits

Industry Sub-Sector	Share in Manufacturing Industry (percent)*
Chemical Products	18.3
Food	14.7
Transport Equipment	12.3
Electrical Machinery	5.8
Garment Industry	3.9
Iron and Steel	3.4

Source: General Directorate of Foreign Capital
(*) as of June 2003

Turkey's External Investment by Country (As of December 2004)

Country	Amount (USD millions)	Share
Netherlands	2,248.8	34.8
Azerbaijan	1,043.6	16.1
United Kingdom	524.2	8.1
Germany	472.1	7.2
Kazakhstan	434.5	6.7

Luxembourg	248.7	3.9
United States	179.8	2.8
Russia	159.7	2.5
France	93.4	1.4
Switzerland	84.9	1.3
Others	976.5	15.1
Total	6,466.2	100.0

Source: General Directorate of Banking and Foreign Exchange, Treasury

Major foreign investors

Turkey's foreign investors include Telecom Italia, Renault, Toyota, Fiat, Castrol, Enron Power, Citibank, Pirelli Tire, Unilever, RJR Nabisco, Philip Morris, United Defense, Honda, Hyundai, Bosch, Siemens, DaimlerChrysler, Chase Manhattan, AEG, Bridgestone-Firestone, Cargill, Novartis, Coca Cola, Colgate-Palmolive, General Electric, ITT, Ford Motor Co., Lockheed Martin, Goodyear, Aventis, McDonald's, Nestle, Mobil, Pepsi, Pfizer, Procter and Gamble, InterGen, Abbot Laboratories, Aria, Bechtel, Shell, Delphi-Packard, Toreador/Madison Oil, AES, GE, NRG, Normandy Mining, Marsa-Kraft-Jacobs Suchard, ESBAS A.S., Archer Daniels Midland, Merck, Sharp Dohme, Bunge, and Bausch and Lomb.
Edelman